

Blue Shield of California

Agenda Item 5b

Responses to issues/questions posed at the March 2008 Health Benefits Committee

The financial position of the Blue Shield HMO and Exclusive Provider Organization plans remains strong. The medical and pharmacy claims twelve month cost trend continues to show close to expected trends for 2007. These financial results, plus adequate reserve levels, provide assurance that the rates approved by the Board for the 2007 plan year were sufficient to cover the cost of healthcare and administrative costs.

Blue Shield consistently uses industry standard methods to set and manage reserves. Based on historical comparisons of actual claims run-out to booked reserves, Blue Shield's reserving for CalPERS has been highly accurate. Independent reviews by external auditors have confirmed that Blue Shield's reserving is reasonable and accurate.

Assets are invested pursuant to the asset allocation guidelines contained in the company's Investment Policy, which is authorized by the Finance and Investment Committee of the Board of Directors. Currently, the amount of cash and investments is well in excess of amounts needed to cover reserved claims liabilities. In accordance with the Investment Policy, the Committee periodically reviews the asset allocation guidelines and makes revisions as appropriate. Currently, the target allocations are 70 percent cash and fixed income investments and 30 percent equities. Every few years Blue Shield completes an asset/liability study which includes examination of a range of sensitivity analyses showing what the assets and liabilities might look like over a 5 or 10 year period under various market environment scenarios and assuming different asset structures. Target allocations are based on the results of this periodic review.

With regard to reserve levels and their impact on rates, the CalPERS rates are projected based upon an up-to-date look at actual healthcare costs reflecting the most recent completed period, i.e., 2006 cost of healthcare was used to project the 2008 rates developed in early 2007. Included in the base 2006 costs is an estimate of Incurred but Not Paid (IBNP) claims, or reserves. Blue Shield has a rollover provision in its contract with CalPERS that allows for the comparison of the actual cost of healthcare and the projected cost of healthcare used to set the previous year's rates and applies the difference to the following year's rates based on the contract provision. When claim costs have been more or less than expected, reserves are restated or "corrected" in later periods and any excess or deficiency in reserves is shared through the rollover to protect both CalPERS and Blue Shield when the projected cost of healthcare does not match actual experience.

With regard to investment returns and their impact on rates, in fully insured products, such as the Blue Shield CalPERS plans, investment gains and losses are not allocated to reserves and thus have no impact on rates.